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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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THE MARKET On May 31 three major indicators, the Industrial Average, the Rail Average and the advance-decline ratio, recorded 1963 recovery highs. Since that time all three indicators have retreated to the accompaniment of noticeably reduced volume. The question on everyone's mind is -- has the market "stepped back" to consolidate in preparation for another upward thrust? Or has the market "topped out" just under the highs?

As stated in the last Letter, most major trouble in the past has been prefaced by divergence or non-confirmation between Industrials and Rails (with the A-D ratio usually topping out first). So far, this type of dangerous action has not made an appearance. Letter 221 suggested that "even if trouble is around the corner, the odds would seem to favor another assault on the May 31 peaks (at which time divergence may or may not appear)." I am still of that opinion.

A number of conflicting and confusing phenomena have appeared in this market, and I feel that they are worth discussing: (1) Daily new highs (see Letter 221) probably topped out in April, 1963. Based on the past history of this index, trouble can generally be expected around three or four months later (this would put the danger area around July or August.) (2) The advance-decline ratio has, over the past few weeks, acted weaker than the Industrial Average. A series of new Industrial highs (above 726.96) unconfirmed by new recovery peaks in the A-D ratio would be an almost sure signal for trouble ahead. (3) A goodly number of stocks on the American Exchange are breaking to new 1962-63 lows (actually below their 1962 "crash" lows). This is highly unusual in a "bull swing", and it is well worth pondering. This action is reflected on the American Exchange's A-D ratio -- which broke to a new 1963 low last week. (4) The Industrial Average has now fallen out of the huge "rising wedge" pattern which was described in Letter 219. This could easily call for an important downward movement. (5) Many individual stocks have been breaking out of bullish patterns, only to flop back again through lack of buying interest. This is the type of action which was seen during much of 1961. (6) As against these unhappy observations,

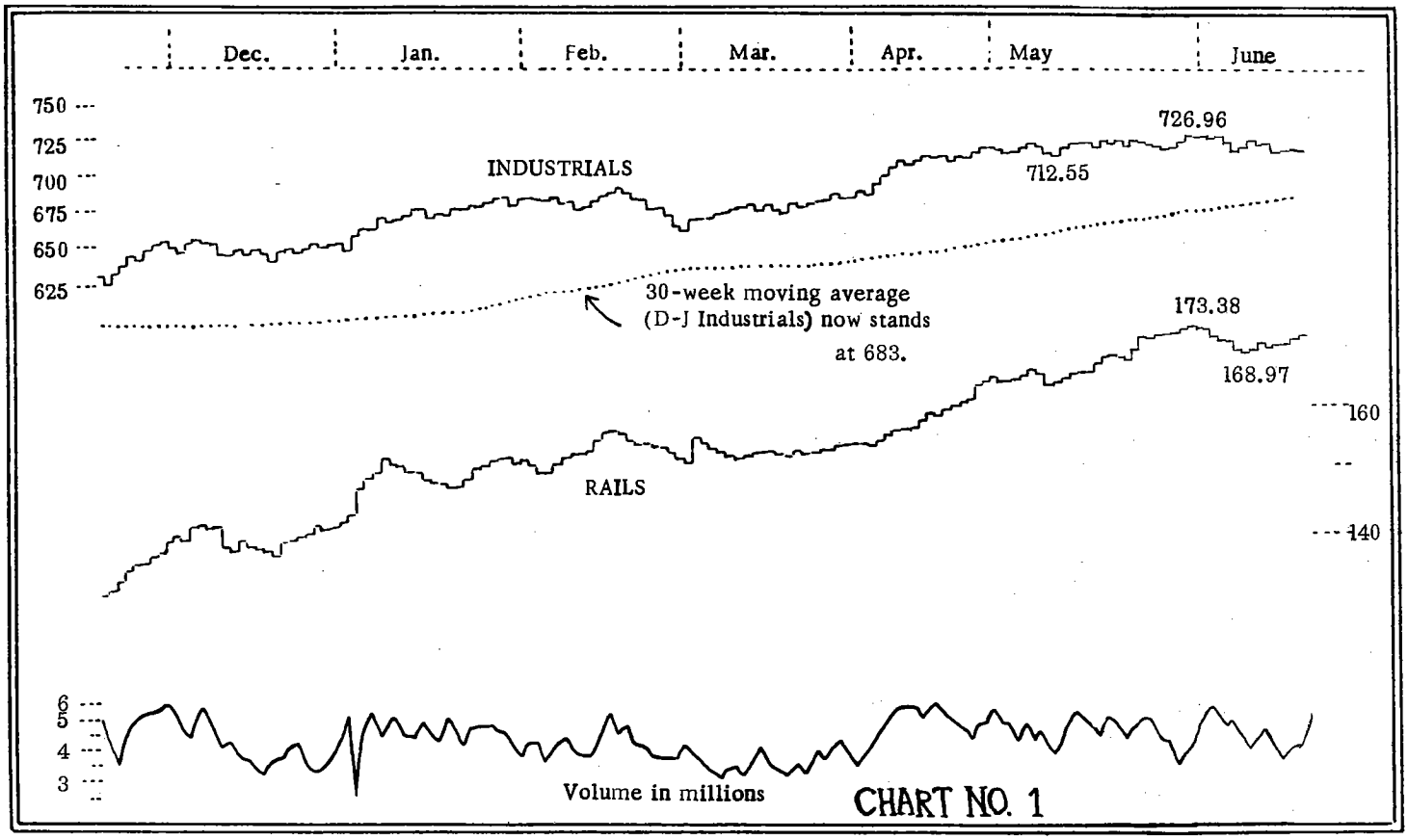
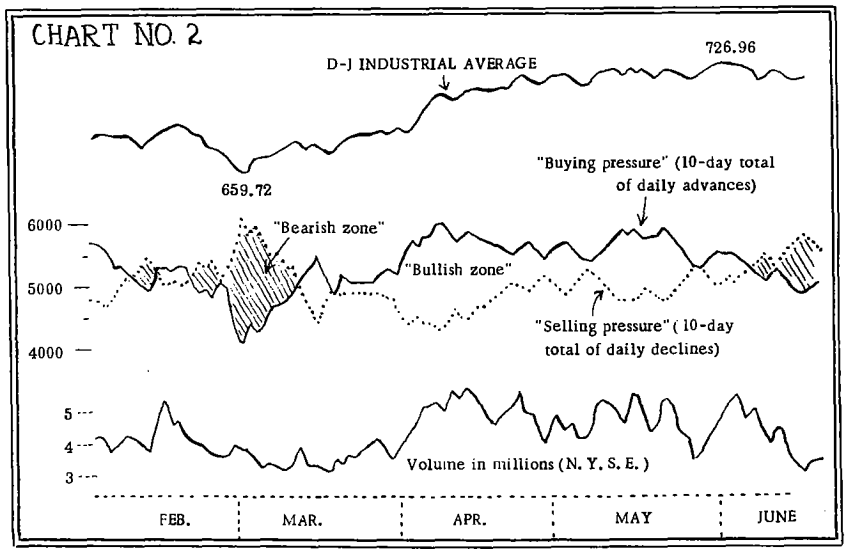


CHART NO. 1

I note that odd-lotters have sold on balance during 42 out of the past 43 weeks. For persistence of public bearishness, there has never been anything to match this performance. Moreover, odd-lotters have sold at a relatively high rate (during the first five months of 1963, odd-lotters sold an average of 12 shares for every 10 they bought -- a heavy rate of selling.) (7) This market has not turned "speculative" during the entire 1962-63 rise. Most major advances terminate with at least a burst of recognizable speculative activity (there have been exceptions such as 1947 and 1948).

So those are the enigmas. And meanwhile, over the past 43 trading days (since April 23) Industrials have held within a remarkably narrow range bordered by 726.96 on the upside (see chart 1) and 712.55 on the downside. This amounts to a 2% range for a period of almost two months. Periods of dullness and inactivity are often followed by periods of surprising activity. The 1963 recovery highs for Industrials and Rails were 726.96 and 173.38. Recent significant lows were 712.55 and 168.97. Joint penetration above or below those two sets of figures will point the way to the next definite trend. It is also well to remember that a refusal by one Average to confirm the penetration of the other can lead to an important reversal.

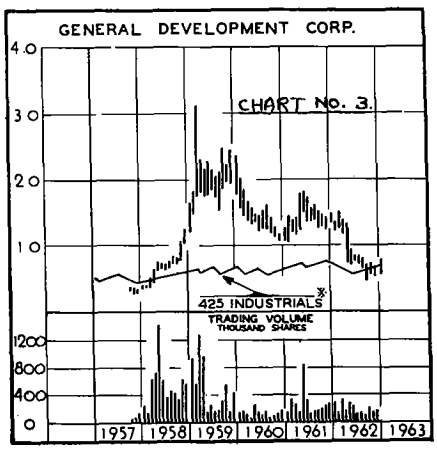
BUYING AND SELLING PRESSURE On May 7 the selling pressure line rose above the buying line. As of this writing, the selling line has held the dominant position for ten consecutive days. Despite the fact that daily declines are now outnumbering daily advances (on a 10-day average basis) no significant downside selling pressure has developed. Moreover, daily volume (see chart no. 2) has dropped rather sharply during the current period, and if this continues, it will be a rather encouraging feature of the market. The story has not yet been told, however, and the selling line is still well above the buying line. As long as this relationship exists, the caution flags will be flying.



BIG PICTURE Last week's Letter regarding the U. S. balance-of-payments problem aroused a remarkable amount of interest from subscribers, and I received correspondence from all parts of the country asking for more on the "big picture".

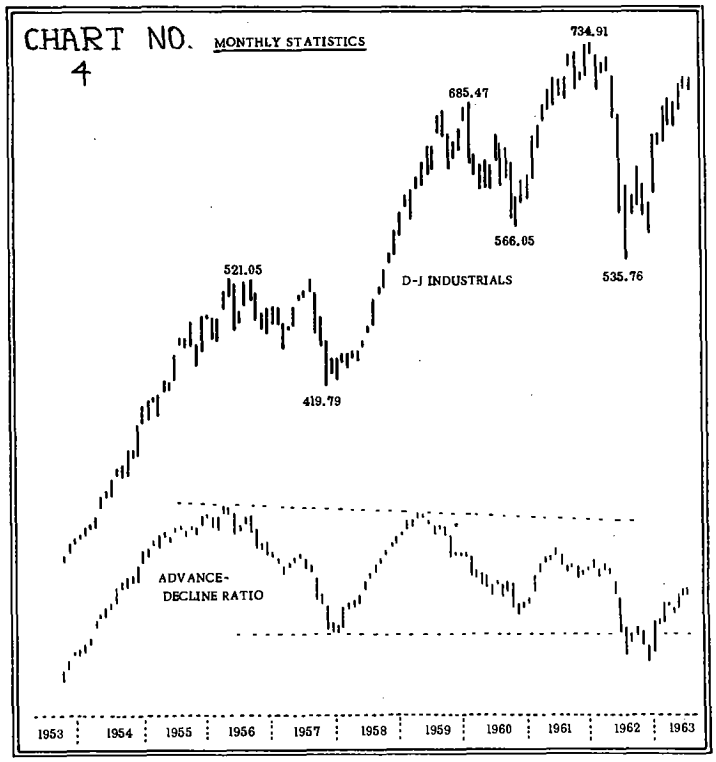
Almost without exception, major wars have been followed in this country by increased business activity and inflation. Yet this expanded activity and inflation seem to affect different segments of the economy in different ways. For instance, after World War I commodity prices literally exploded -- only to be followed by the drastic price collapse of 1920-21. From a 1921 base, commodities again pushed higher along with real estate and common stocks. But commodity prices halted their advance in 1925 (at a level considerably below the peak 1920 prices), while real estate speculation continued into 1926. In the year 1926 the "heart" of the U. S. real estate boom, Florida land, collapsed. Although real estate continued to flourish until 1929, it never regained the "pie-in-the-sky" status which it enjoyed prior to 1926. Between 1926 and 1929 the remaining real estate fever centered in business properties and apartment houses (where, of course, it is centered today). With speculative interest in real estate and commodities having subsided after 1926, it was perhaps only natural that the main attention should finally turn to stocks. From the 1926 low of 135, the D-J Industrial Average rose 182% to the 381 high of 1929. In 1929 stocks caved in -- thereby winding up the great speculative orgy of the 1920's.

Following World War II commodities again surged higher -- to establish a peak in 1946. After a mild decline, commodity prices climbed to a new peak during the Korean War period of 1951. The Korean heights have not since been approached. Real estate and land values headed sharply higher after World Was II, touching probable peaks around 1959-61. Again (as in the 1920's) the resort areas received the greatest speculative attention with Florida and Southern California in the fore. The accompanying chart (No. 3) of General Development (a leading Florida land development and construction company) provides a good picture of the fantastic 1959-60 run-up in real estate stocks. Florida real estate stocks collapsed in 1960, while the real estate syndicate equities caved in during 1962. It would be safe to venture the opinion that real estate has now passed its zenith as far as speculation is concerned. In view of all this, I feel that it remains for the stock market to show us whether speculation is still alive.



Perhaps the most important "picture" of the market is now provided by chart No. 4 -- which shows the monthly range of the Industrial Average and the advance-decline line over the past eleven years. This chart helps to explain why there has been so much frustration connected with the 1962-63 advance. The reason is that a great number of

stocks simply have not participated in the rise, while other issues have participated in only a minor way. Of great interest to this writer is the fact that the A-D ratio on the American Exchange (see Letter 219) has just broken to a 1963 low and is currently only a fraction above its June, 1962 low. Obviously, many American Exchange issues have continued to sink to new 1962-63 lows, and many of these issues are still held by the public. It is possible that the public will not be ready to speculate until (or unless) the American Exchange issues show signs of coming to life again.

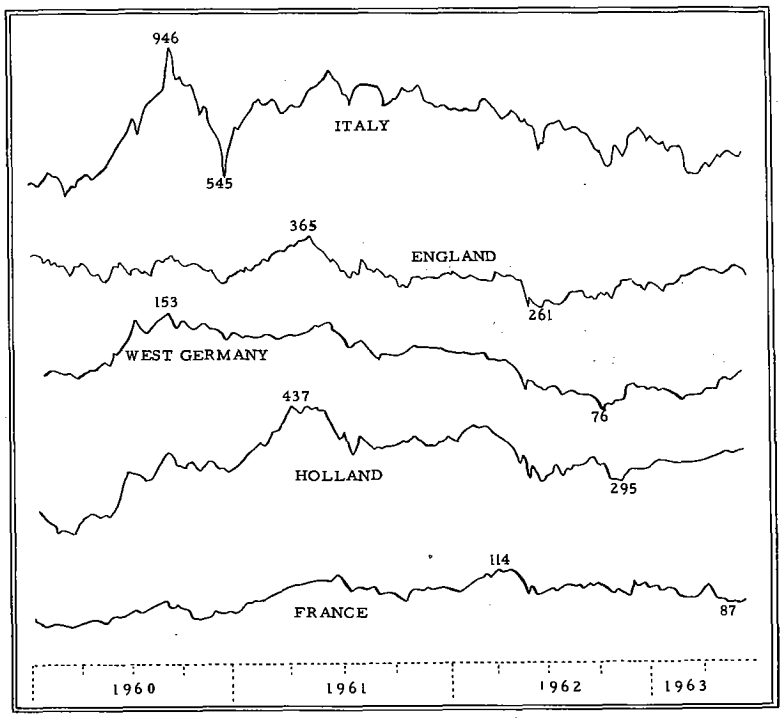


An extremely interesting comment on the entire problem was recently written by James Hughes of New York, an expert student of the A-D ratio:

> "Since March 1959 the major trends of breadth and price, during an advancing phase in price, have been in harmony only from December 1960 to May 1961 and from the October lows in 1962 to the recent highs early in June. This means that over a period of fifty months the breadth index and the industrial average have been in harmony during the course of two advances for a total of only twelve months. On the basis of this record it would seem justifiable to assume that the market as a whole is very much lower than is indicated by the performance of the industrial average."

FOREIGN MARKETS It has been six months (Letter 207) since I have discussed the major foreign stock markets. As far as I know, Robert Rhea (writing in the 1930's) was the first analyst to make a point of following and comparing the foreign exchanges with the American stock exchange.

I began publishing profiles of the major foreign markets some years ago, and this study has since gained acceptance among a number of leading services. In fact, Barron's now issues a tabulation of the weekly closings of important foreign markets (prior to Barron's such figures were available in list form only from the London Financial Times).



It may be of interest to readers to know that only the New York Stock Exchange possesses a full technical picture of its own action, thanks chiefly to the historical records of Dow Jones & Co. As recently as three years ago I found it impossible to gather historical statistics regarding major foreign exchanges, statistics as simple as the weekly closings of leading stock averages. The idea of keeping charts of stock averages has gained increasing acceptance over the past year or two, and now when one calls the Bank of France in New York and asks: "What is your market doing?" there is a fair chance that he will receive some sort of an intelligent answer (but don't count on it).

All primary movements tend to be international in character. The accompanying chart (Chart No. 5) probably best illustrates this phenomenon.

Note that between 1960 and 1962, almost every stock exchange in the world formed a major top and turned down. The Italian market "crashed" in 1960, West German stocks saw their highs that same year, London touched its peak in late 1960, Holland and France celebrated their peaks in 1961, and the U. S. touched its bull market high in 1962.

None of these leading markets have seen their stock averages record new highs since the aforementioned peaks. All, however, have enjoyed some measure of recovery since the highs.

Italy struck a secondary peak in 1961; then, as is so characteristic of markets following a crash, the Italian market slowly sank back to the crash lows again. Currently, the Italian average is slightly above its 1963 low, but nothing resembling a bull market has been seen.

Having struck its bear market low in 1962, the London market has subsequently moved up to approximately the 1962 highs. London is still substantially below its 1961 peak, however.

West Germany's market broke badly during 1961 and 1962. Since then a long sideways movement has occurred, and so far the movement resembles a possible base for an important rise. A large upward zig-zag has formed in the German stock average, and as long as the 1963 low is not broken, the German market should be considered bullish.

The profile of the Dutch market closely resembles the German affair. In 1963 the Dutch average pushed above its mid-1962 high, and this market can also be labeled bullish.

Despite the fact that France is reputed to have the strongest currency in the Free World, its stock market has been slipping ever since early 1962. Over the past few months, the French stock average has dropped to its 1960 level -- thus France has given one of the poorest performances of any of the leading Western nations over the past year.

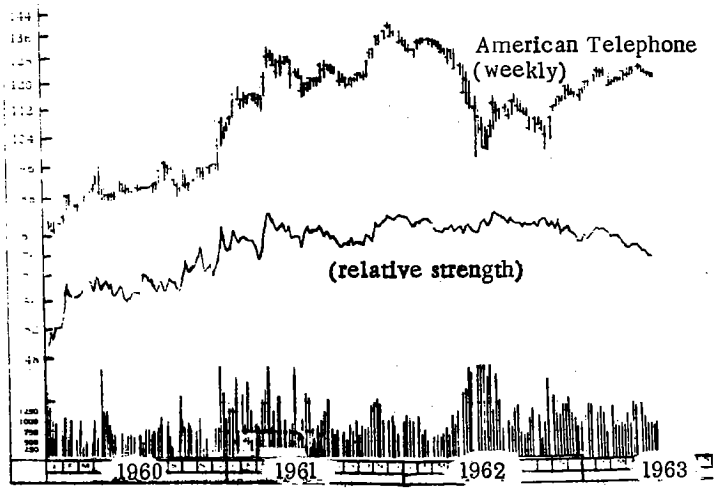
All in all, it can be said that none of the major foreign stock averages have performed as well as the D-J Industrial Average over the past year.

STOCKS Of 444 stocks tabulated weekly at this office, 362 or 81% are now holding above their long-term (30-week) moving average (a drop of 5% from last week).

The subject of relative strength is a fascinating (and I feel neglected) one. Often future probabilities can be detected from the action of a stock or a group when that stock or group is compared with the general market. Relative strength trends are often more persistent than price trends, and you can sometimes spot strength or weakness a year ahead with a relative strength chart.

I have included below a chart of the utility group(relative strength) for the past five years. Note that an excellent trendline has been established, a trendline which implied that utility stocks have been stronger than the market ever since 1959. Over the past few months that strength has turned, and utilities are now a "sale" on the basis of group relative strength. Whether the New Frontier has "plans" for the utility industry or something else is in the wind, I do not know. The relative strength chart does not explain "why".

American Telephone (T) provides an individual example of relative strength. The weekly chart shows the strong relative strength picture during 1960 and early '61. During 1962 T's relative strength line flattened out, and toward late 1962 and 1963 it became apparent that this old line favorite (now considered a "growth stock") was steadily weakening on a relative strength basis. Such action often leads to a sudden dramatic decline, a decline which may only be foreshadowed by persistent relative strength weakness.



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